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INSIGHTS

Texas Supreme Court Rejects a General Cause of Action for Minority Shareholder Oppression

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The Supreme Court of the State of Texas recently issued a significant opinion relating to the remedies available to minority shareholders of Texas corporations. In *Ritchie v. Rupe*, No. 11-0447 (Tex. June 20, 2014), *available* ***here***, the Court applied a text-based approach to statutory interpretation and noted with approval the ability of Texas corporations and their shareholders to govern intra-corporate relations by contract. In the carefully drafted opinion, the Court:

- Declined to recognize or create a new common law cause of action for "minority shareholder oppression" in the face of the ability of shareholders of Texas corporations to protect themselves from such actions by contract, as well as adequate existing statutory and common law remedies for actionable conduct.

- Defined "oppression" for purposes of the predecessor of the current Texas statute (predecessor statute) governing the right of minority shareholders to obtain a court-appointed receivership based on "illegal, oppressive or fraudulent" conduct by directors. The current version of the statute, effective in 2003, contains no material differences from the predecessor statute for the issues in this case. The Court held that "oppression" under the predecessor and current statutes occurs when directors abuse their authority over the corporations with the intent to harm the interests of one or more of the shareholders in a manner that does not comport with the honest exercise of their business judgment, and by doing so create a serious risk of harm to the corporation. The Court expressly disapproved of seven prior opinions of the courts of appeals.

- Declined to expand the remedies available under the predecessor statute beyond the receivership remedy specified in the statute. The court also concluded that the predecessor statute (and its current version) applies to *all* Texas corporations, not just closely-held entities.

- Confirmed the judiciary's power to impose equitable remedies for common law breaches of fiduciary duty, including orders requiring the purchase of shares held by a minority shareholder.

- Determined that the refusal by members of a board of directors to meet with potential purchasers of shares owned by a minority shareholder, or to buy such shares at fair market value, was not "oppressive" within the meaning of the predecessor statute.

- Confirmed the applicability of existing common law remedies for breach of fiduciary duty, including breach of the duty of loyalty, in appropriate circumstances involving failure to declare dividends, misappropriation of corporate funds and diversion of corporate opportunities. The Court also confirmed the efficacy of specific statutory provisions, such as the Texas statutory protections against denial of access to corporate records and the legislative scheme established governing statutory "close corporations," which permit fashioning individualized solutions for minority shareholders.

- Confirmed that no *formal* fiduciary duty exists between the majority and minority stockholders in a closely-held Texas corporation, but also confirmed that *informal* fiduciary duties between such shareholders may arise from moral, social, domestic or purely personal relationships of trust and confidence.

- Although not an issue raised by Petitioners, the dissenting opinion, *available* ***here***, and the court of appeals in this case addressed the issue of whether termination by the corporation of the employment of a minority shareholder could be the basis of a claim for breach of fiduciary duty. The Supreme Court re-affirmed the importance of the state's "at-will" employment policy, stating that in the absence of an employment contract, a court will not presume that the corporation and its shareholder have elected to forgo their at-will employment rights. However, the Court noted that there may be circumstances when termination of an employee is improper in the absence of an employment agreement and could violate the directors' fiduciary duties to exercise their "uncorrupted business judgment for the sole benefit of the corporation." In those cases, a shareholder may enforce such duties through a derivative action. An employment termination that violated the directors' fiduciary duty also could be potentially oppressive under the current Texas receivership statute and justify the appointment of a rehabilitative receiver.

Factual Background

The facts of the case add context to the Court's holding. Ann Caldwell Rupe was trustee of a trust holding an 18% minority interest in Rupe Investment Corp., a closely held, family-owned investment holding company. The company and its owners were not parties to the shareholders agreement. Rupe sued director Lee C. Ritchie and other executives who were also shareholders, alleging they stymied her efforts to sell her stock by refusing to meet with, and restricting information provided to, prospective third-party buyers. The company had offered to redeem her shares for $1.7 million — a deal Rupe rejected as "absurd" for a company with $50 million in assets and $150 million in annual sales. She argued that the company directors should have done more to help her sell her stock, including meeting with potential purchasers. She asserted that the directors' refusal to do so constituted shareholder oppression under the Texas Business Corporations Act and breach of the common law fiduciary duty. The trial court judgment awarded $7.3 million to the minority shareholder, as the price the company must pay for her stock, and the court of appeals affirmed. For the reasons enumerated above, the Supreme Court reversed the court of appeals but remanded the case to that court to consider the breach of fiduciary duty claims that it had not addressed.

Takeaways

Texas corporations and their advisors should consider the following implications from the Court's decision in *Ritchie v Rupe*:

- Minority shareholders of a Texas corporation that want special protections, such as the right to require the corporation to purchase their shares, to limit the transferability of the shares and the like, should insist either that the corporation elect to be a statutory close corporation or require a shareholders agreement providing the desired rights.

- Close corporations in which there is overlap among the shareholders, directors and officers present numerous fiduciary duty issues of great complexity. While a majority shareholder may owe no duty to the minority shareholder based solely on share ownership, if the majority shareholder is also a director, actions in a directorial capacity will be judged under the business judgment rule, including the duty of loyalty. In addition, if the shareholders also have family or other close relationships outside of the corporation, an informal duty based on this relationship of trust and confidence may be arise. Under those circumstances, individuals must take great care to ensure their actions are not found to violate one or more of these duties.

- Publicly-held corporations incorporated in Texas must take care not to engage in “illegal, oppressive or fraudulent” activities, as it is now clear that those actions will support an action for receivership under the Texas Business Organizations Code.

- When terminating an executive that is a stockholder, all Texas corporations should bear in mind that an improper termination that violates the directors’ fiduciary duties may give rise to a derivative action for breach of such duties, and if successful, could result in the appointment of a rehabilitative receiver.

The Court may have another opportunity to define the parameters of the duty of loyalty, should the case be appealed after remand. Texas corporations and their advisors should continue to monitor this case for future developments.